

**MINUTES OF THE REGULAR MEETING OF THE  
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**HELD ON  
Friday, September 21, 2001  
8:30 a.m. MST**

The Arizona State Retirement System (ASRS) Board met in the 10<sup>th</sup> Floor Board Room of the ASRS office at 3300 North Central Avenue, Phoenix, Arizona 85012. Mr. Jim Bruner, ASRS Board Chairman, called the meeting to order at 8:30 a.m., MST.

The meeting was teleconferenced to the ASRS office, 7660 East Broadway Boulevard, Suite 108, Tucson, Arizona 85710.

**1. Call to Order; Roll Call.**

Present: Mr. Jim Bruner  
Mr. Norman Miller  
Dr. Merlin DuVal  
Dr. Chuck Essigs  
Ms. Bonnie Gonzalez  
Mr. Jim Jenkins  
Mr. Alan Maguire (arrived at 8:34 a.m.)  
Mr. Karl Polen (arrived at 8:32 a.m.)  
Mr. Ray Rottas

A quorum was present for the purpose of conducting business.

**2. Presentation of Plaque of Appreciation to Dr. Chuck Essigs**

Mr. Jim Bruner presented a plaque of appreciation to Dr. Chuck Essigs for serving as Board chairman for the 2000-2001 fiscal year. Mr. Bruner commended Dr. Essigs for always being responsive to Board members and the members of the ASRS.

Mr. LeRoy Gilbertson, Director, also thanked Dr. Essigs for being accessible to the staff and for his willingness to communicate on any issue. Dr. Essigs thanked the Board and the staff for their support during the year.

**Mr. Karl Polen arrived at 8:32 a.m.**

**3. Approval of Minutes of the June 14, 2001, Regular Meeting, the August 17, 2001, Regular Meeting, and the August 17, 2001, Executive Session of the ASRS Board**

**Motion:** Noting that his concerns about policy and procedure have been recognized, Mr. Ray Rottas moved to approve the minutes of the June 14, 2001, regular meeting of the ASRS Board as submitted.

Dr. Merlin DuVal seconded the motion.

By a vote of 7 in favor, 0 opposed, 1 abstention, 1 excused, the motion was approved.

**Motion:** Dr. Merlin DuVal moved to approve the minutes of the August 17, 2001, regular meeting of the ASRS Board.

Mr. Norman Miller seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

**Motion:** Dr. Merlin DuVal moved to approve the minutes of the August 17, 2001, executive session of the ASRS Board.

Ms. Bonnie Gonzalez seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

**4. Board Approval of Consent Schedule.**

**Motion:** Dr. Merlin DuVal moved to approve the summary report of Retirements, Refunds and Death Benefits, Transfer Requests, and Application and Agreements with the Following Employers:

- A. Davis Education Center
- B. Success School dba Arizona Charter Academy
- C. Superior School
- D. Desert Rose Academy
- E. Town of Duncan
- F. Diamond Star Fire District

Dr. Chuck Essigs seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, 1 excused, the motion was approved.

**Mr. Alan Maguire arrived at 8:34 a.m.**

**5. Presentation, Discussion and Appropriate Action Regarding the Vendor Selection Recommendation for the Disposition of the Bank One Commercial Mortgage Portfolio.**

Mr. Alan Maguire, Chairman, Request for Proposal (RFP) Evaluation Committee, thanked the ASRS

staff and Mr. Norman Miller for their participation in a thorough vendor selection process. After reviewing the excellent proposals of numerous respondents, the evaluation committee selected three leading firms to interview. The committee then agreed that Secured Capital Corporation should handle the disposition of the portfolio for the ASRS.

**Motion:** Mr. Maguire moved to award the contract to Secured Capital Corporation to act as the loan sale advisor and implementor pertaining to the disposition of the Bank One Commercial Mortgage Portfolio.

Mr. Norman Miller seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, 0 excused, the motion was approved.

**6. Presentation, Discussion and Appropriate Regarding Notice of Proposed Rulemaking to Amend R2-8-126 Regarding New Factors for Determining Reduced Monthly Annuity for Partial Lump Sum Option; and New Factors for 5, 10, 15 Year Certain and Life Annuities with Pop-Up.**

Mr. Fred Stork, Assistant Attorney General, reported that the Arizona State Legislature amended the statutes to provide some additional benefit options for retiring ASRS members. As a result, revised factors prepared by the actuary should be used to calculate the new benefits under the new options. Procedurally, the factors are to be included in the Board Rules, and he recommends the Board authorize the commencement of the rulemaking process.

Dr. Chuck Essigs asked about the procedure for rulemaking. Mr. Stork answered that the notice of proposed rulemaking will be published in the register and there will be a 30-day period for any public comments. The Board will then consider adoption at a future Board meeting.

Mr. Jim Jenkins asked when the Partial Lump Sum option will be available to members. Mr. Stork answered that it is not available until next year, but it is appropriate to get the factors on the books before the benefit option becomes effective.

**Motion:** Mr. Maguire moved to amend rule R2-8-126 regarding the new factors for determining reduced monthly annuity for partial lump sum option and the new factors for 5, 10, 15 year certain and life annuities with pop-up, and that the director file with the secretary of state the notice of proposed rulemaking.

Mr. Jim Jenkins seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, 0 excused, the motion was approved.

**7. Presentation, Discussion and Appropriate Action Regarding Corporate Governance and Executive Compensation**

Mr. Terry Dennison, Principal, Mercer Investment Consulting, Inc., presented an overview of proxy voting and executive compensation issues. Proxy voting is the shareholders opportunity to affect corporate governance. He outlined issues that typically can be voted on by proxy: for example, routine elections,

non-controversial stock options, or management initiated issues like executive compensation. Shareholders who hold more than 100 shares may also propose initiatives, with some restrictions: for example, governance issues such as anti-take over provision, financial issues such as compensation, and behavioral issues such as environmental considerations, labor rights or undesirable products.

Mr. Dennison noted that the ASRS guidelines and policies are based on maximizing economic value to the ASRS fund without regard to non-economic issues. Each investment manager can vote proxies on the securities they manage and external managers may use the ASRS policy and guidelines at their discretion.

In recent years, executive compensation has become a more visible issue. Compensation is a mix of base salary, incentive bonuses, deferred compensation and stock options. Excessive executive payments may reduce the value of the investments of shareholders. The ASRS proxy voting policy contains provisions for addressing plans providing for excessive windfalls, plans providing bonuses where shareholders do not benefit and plans that dilute the interests of the shareholders. Mercer Investment Consulting believes the ASRS proxy voting policy is reasonable and provides appropriate discretion to deal with individual facts and circumstances. However, Mercer recommends the ASRS consider amending the policy to generally oppose provisions in options programs that permit repricing of stock options granted to senior management. Mr. Matson agreed, in general, with this and indicated that it would become explicit in the policy and procedure.

Mr. Norman Miller asked if the managers who vote the ASRS proxies are conforming to the ASRS policy. Mr. Paul Matson, Chief Investment Officer, replied that approximately 18 months ago the ASRS disseminated its internal policies and procedures on proxy voting to all of the external managers and asked them to compare them to their own policies. The managers responded that there were generally no significant differences. Mr. Miller asked whether it would be beneficial to do an impromptu audit of the managers' proxy performance. Mr. Matson responded that approximately 18 months ago the ASRS asked each manager to sign a statement that they have been following their own internal guidelines, and that the ASRS could request that the managers' internal auditors periodically sign a similar statement, but there was no significant evidence that this would add value to the external investment process.

Mr. Polen noted that there are some instances where repricing stock options to maintain incentives and retain key management is in the best interest of the shareholders. He would not support a policy automatically voting against repricing of options but agrees that they should be examined carefully.

Dr. Merlin DuVal commented that he had requested this topic be presented because of noticeable excessive executive compensation for some senior management that are not in alignment with shareholders and stock values, and he thanked Mr. Dennison for his comprehensive presentation of the issue.

## **8. Director's Report**

Mr. Anthony Guarino, Deputy Director, Chief Operations Officer, gave an update of the internal operations and emergency management procedures of the ASRS as a result of the attacks in the United States. He is confident that, if the ASRS building had to close down, member data would be secured, benefits paid, limited phone service provided, and contributions collected and posted. Although there are paper files that may not survive even with the fire suppression system, the imaging project underway will eventually minimize that risk. In addition, security measures have been elevated: doors require access

codes, daily sweeps of workspaces for any unusual items are conducted, and building management has increased security personnel and met with tenants for coordinated response efforts.

Mr. Miller asked if all records are kept in the ASRS building. Mr. Guarino responded that a large portion of the data is on electronic file. Mr. Kent Smith, Assistant Director Information Services, reported that the files are backed-up daily and sent to Library and Archives on a weekly basis. Some information is also on microfilm and microfiche, which is also stored off-site. Mr. Guarino noted that from the off-site records basic account information could be reconstructed.

Mr. Paul Matson, Chief Investment Officer, reported that on the day of the terrorist activity, the investment staff conducted an analysis of priorities: benefits payment, cash availability, portfolio liquidity, lending liquidity and operational portfolio management. Payments were not disrupted, cash was available, and nothing stood out as a potential issue on liquidity. Currently, there is a five-day transaction period for bonds while equity settlements are three-day periods. This may create potential mismatches on trading between stocks and bonds, but there are several strategies to minimize or eliminate any unbalance in the asset allocation.

Mr. Polen asked Mr. Dennison to provide an economic prognosis. Mr. Dennison noted that the economy was already in a gradual decline. The Federal Reserve has injected liquidity into the market but there has also been a change in fiscal policy and the government is spending more money, which may cause inflation in the next few years. In the short term, there may be negative returns that will probably push the country into a recession.

Mr. LeRoy Gilbertson complimented Mr. Guarino and Mr. Matson for their efforts during the events to help calm staff and the ASRS members.

## **9. Board Requests for Agenda Items**

There were no requests for future agenda items from Board members.

## **10. Call to the Public**

Mr. Gale Richards, of Phoenix, commented on the sound system.

There were no requests to speak from the Tucson public.

## **11. The next ASRS Board meeting is scheduled for Friday, October 19, 2001 at 8:30 a.m. in the 10<sup>th</sup> Floor Board Room of the ASRS office at 3300 North Central Avenue, Phoenix, Arizona 85067-3910.**

## **12. Adjournment of the ASRS Board.**

Mr. Jim Bruner adjourned the September 21, 2001 meeting of the ASRS Board at 9:48 a.m.

Respectfully submitted,

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Maurah Harrison, Secretary	Date	LeRoy Gilbertson, Director	Date